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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1937

No. 349

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

SELLAR BULLARD, AS EXECUTOR UNDER THE LAST WILL AND TESTAMENT OF CLARA R. SMITH, DECEASED,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Brief for Respondent.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Brief for Respondent.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 134-148) is reported in 34 B. T. A. 243.

The opinion of the United States Circuit Court of Appeals for the Seventh Circuit (R. 165-172) is reported in 90 F. (2d) 144.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 25, 1937 (R. 172). The petition for writ of certiorari was filed August 25, 1937, and granted October 11, 1937.

The Questions Presented.

The issues are:

(1) Whether a certain indenture executed by decedent on February 17, 1932, whereby an irrevocable *inter vivos* trust was created, was a transfer by decedent of property owned by her, within the application of Section 302(c), Revenue Act of 1926, as amended by Joint Resolution (Pub. 131), approved March 3, 1931, or as further amended by Section 803(a), Revenue Act of 1932.

(2) Whether, if said Section 302(c), as amended as aforesaid, may apply to the 1932 trust, said statute prospectively applied is not unconstitutional as in violation of the due process of law clause of the Fifth Amendment of the Federal Constitution.

(3) Whether, if the application of the taxing statute is to be determined with respect to a prior irrevocable *inter vivos* trust created by decedent on March 3, 1927, and not with respect to the 1932 trust, (the 1932 trust being held not to be a separate transfer by decedent of her own property), the 1931 or 1932 amendments to said Section 302(c), Revenue Act of 1926, may be construed to apply to such a trust created before March 3, 1931, and if so construed and applied, whether those enactments are not unconstitutional.

The Statutes Involved.

The statutes involved will be found in the Appendix, *infra* pp. 45, 46.

Statement.

Clara R. Smith, a resident of the State of Illinois, died testate on May 24, 1933. On March 3, 1927, she had created an irrevocable *inter vivos* trust consisting of securities which, in 1932, were valued in excess of $300,000, under which trust she reserved the income to herself for life. The trust instrument provided that upon decedent's death the trust should be divided into three equal funds, the income from which respective trusts was to be paid to decedent's three children,—Lora, Bessie, and Edward,—during their lives, with the remainders of the shares of the two daughters to their respective children. Upon Edward's death, in the event that no issue survived him, (which event actually occurred) the income from his share was to be paid to his widow for life, and upon her death the remainder was to be added in equal shares to the other two funds (Ex. 1, R. 37; R. 136, 165).

Edward Smith died in 1928, having had no children, but leaving a widow, Virginia Smith, surviving him (R. 17, 137, 165).

In 1931 decedent instituted a suit to have the 1927 trust declared void on the ground that the ultimate remainders in Edward's one-third after the life estate in the "widow" of Edward violated the rule against perpetuities, alleging that by reason of said invalidity of such provisions the scheme of the trust was destroyed, and praying that the entire trust corpus be ordered returned to decedent free of the trust (Ex. 3, R. 50; R. 23, 34, 35, 138).

Virginia Smith, widow of Edward, took a firm position in opposition to this action, contending that the trust was valid *in toto* (R. 35, 138, 166). Decedent's action was also opposed by the *guardian ad litem* appointed by the court to represent the interests of the infant beneficiaries in

remainder, children and grandchildren of the two daughters (R. 26-28).

Thereafter, in order to settle the pending suit, an oral compromise agreement was entered into by all the adult beneficiaries under the 1927 trust, including decedent and Virginia Smith, which agreement provided as follows:

1. All the adult defendant beneficiaries agreed to consent to the entry of a decree in the pending suit, according to the prayer of the bill; said decree to recite the termination of the 1927 trust and the restoration of the property held thereunder to decedent, provided that—

a. Before entry of the consent decree, a new trust would be declared of approximately one-third of the same securities held under the 1927 trust. Under this trust decedent was to receive the income for life, and Virginia Smith a life interest identical to that held by her under the 1927 trust, and upon her death the corpus would be divided between decedent's two daughters equally;

b. Securities of the value of $10,000 were to be transferred from the 1927 trust to each of two adult grandchildren, beneficiaries in remainder under the 1927 trust;

c. A new will would be executed by decedent, to remain in effect until her death, making the following provisions for the beneficiaries in remainder under the 1927 trust, and particularly for the purpose of protecting the interests of the infant beneficiaries thereunder—

(1) Omission of $53,000 in specific bequests to others than the immediate family under the then existing will;

(2) Bequests of $25,000 each to the three minor grandchildren;

(3) Bequests of $15,000 each to the two adult grandchildren (equalized with the minors by the $10,000 outright transfers of securities);

(4) Provision for two $100,000 trust funds,—one for each of decedent's two daughters for life,—with vested remainders to their respective children;

(5) Residue of her estate to be divided between decedent's two daughters;

2. The balance of the securities comprising the 1927 trust fund remaining after the creation of the new trust and the transfer of securities to the grandchildren, was to be returned to decedent (R. 22, 23, 138, 166).

Each of the provisions of the compromise agreement was carried out (R. 23-26, 35, 36, 138-143, 166), the trustee acting pursuant to instructions with respect to the transfer of one-third of the securities from the old trust into the new trust (Ex. 7, R. 81), the transfer of securities from the old trust to the two grandchildren (Ex. 8, R. 84), and the transfer of the remaining securities from the old trust to decedent (Ex. 8, R. 84). The new trust indenture was executed and delivered prior to the entry of the decree, with decedent as "trustor", on February 17, 1932 (Ex. 4, R. 64). The decree terminating the 1927 trust was entered by consent of the adult beneficiaries on February 27, 1932 (Ex. 20, R. 98), the *guardian ad litem* for the minor beneficiaries having represented to the court that the effectuation of the provisions of the compromise

agreement settling the pending litigation was for the best interests of the minors (R. 26-28).

The Commissioner of Internal Revenue included the corpus of the trust of February 17, 1932, in decedent's gross estate for Federal estate tax purposes, which trust was valued at $112,148.75 at the date of decedent's death (R. 135).

Specification of Errors to be Urged.

The Circuit Court of Appeals erred—

1. In holding that the question of respondent's liability for Federal estate tax must be determined with respect to the 1932 trust.

2. In failing to hold that there is no liability upon respondent for Federal estate tax deficiency for the reason that the question of liability must be determined solely with respect to the irrevocable 1927 trust, and said trust was not subject to the tax.

SUMMARY OF ARGUMENT.

I.

The irrevocable 1927 trust was not subject to Federal estate tax, even though decedent reserved the income therefrom for life. *May* v. *Heiner*, 281 U. S. 238, *Burnet* v. *Northern Trust Co.*, 283 U. S. 782, *Morsman* v. *Burnet*, 283 U. S. 783, *McCormick* v. *Burnet*, 283 U. S. 784.

Since this was so, the 1932 trust cannot be subject to Federal estate tax, for the reason that it was not created by decedent, she having had no equitable ownership in any of the property which constituted the 1932 trust at any time after her creation of the irrevocable 1927 trust except her right to receive the income therefrom, which right had been reserved to her under the 1927 trust. The 1932 trust was actually created by all the beneficiaries of the 1927 trust by virtue of a compromise agreement which provided, among other things, for the creation of said trust. The creation of the 1932 trust was not a gratuitous transfer by anyone, but rested upon the consideration furnished by the mutual determination by the beneficiaries of the 1927 trust of the value of their interests thereunder, in a compromise agreement whereby the pending dispute concerning the validity of the 1927 trust was settled.

However, if the taxing statute as amended be held to have any application to the 1932 trust, said transfer was nevertheless made for an "adequate and full consideration in money or money's worth" within the exemption clause of said statute.

II.

A transfer such as that here involved,—an irrevocable *inter vivos* transfer, not made in contemplation of death, with remainders vested at the time of the transfer but with the reservation to the transferor of the income from the property transferred during his life,—is a pure gift *inter vivos* and is not testamentary in character. *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339; *May* v. *Heiner*, 281 U. S. 238; *Burnet* v. *Northern Trust Co.*, 283 U. S. 782; *Morsman* v. *Burnet*, 283 U. S. 783; *McCormick* v. *Burnet*, 283 U. S. 784.

Although Congress undoubtedly has the power to tax pure gifts *inter vivos* as such, it may not, by classifying pure gifts *inter vivos* with transfers at death and transfers testamentary in character, subject them to the Federal estate tax. Such a classification is so arbitrary and capricious as to be a denial of due process of law under the Fifth Amendment of the Federal Constitution.

Pure gifts *inter vivos*, not testamentary in character, are not within the purview of the Federal estate tax. *Heiner* v. *Donnan*, 285 U. S. 312; *Helvering* v. *St. Louis Union Trust Co.*, 296 U. S. 39.

The classification of such pure gifts *inter vivos* with transfers at death and transfers testamentary in character for the purpose of bringing them within the scope of the Federal estate tax, is not an exercise of the taxing power within the constitutional limitations determined by this Court in *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85, 90, for the following reasons: (1) Such classification is not necessary to prevent evasion of tax, since pure gifts *inter vivos* such as that here involved may properly be reached by a gift tax upon such transfers. (2)

The classification is unreasonably harsh and oppressive when viewed in the light of the expected benefit, since its effect is to include in the decedent's gross estate for the purpose of measuring the tax thereon, property absolutely and irrevocably transferred to persons other than decedent during her lifetime; that is, it is to measure the tax upon A's property by imputing to it in part the value of the property of B, a result condemned in *Heiner* v. *Donnan, supra,* and in *Hoeper* v. *Tax Commission,* 284 U. S. 206. (3) The classification arbitrarily ignores recognized rights to enjoy and convey individual property, since the effect of the classification is to deny to a decedent the right freely to give his property to another by absolute gift bearing no relation to death without subjecting his estate to a death tax upon such property.

The tax upon the value of the vested remainder interests irrevocably transferred *inter vivos* is, in effect, a direct tax which is in violation of Article I, Section 9, subdivision 4 of the Constitution, because not apportioned as therein provided.

If the tax be unconstitutional as a denial of due process of law for any reason whatsoever, it cannot be upheld, even though it should be a measure reasonably requisite to prevent evasion. *Heiner* v. *Donnan, supra; Hoeper* v. *Tax Commission, supra; Schlesinger* v. *Wisconsin,* 270 U. S. 230.

III.

If it shall be held that the question of liability for the tax must be determined with respect to the irrevocable 1927 trust and not with respect to the 1932 trust,—the 1932 trust being held not to be a separate transfer by decedent of her own property,—neither the 1931 nor 1932 amend-

ments to said Section 302(c), Revenue Act of 1926, may be construed to apply to the 1927 trust created before March 3, 1931; or if they should be so construed to apply to said trust, then these enactments are unconstitutional. See brief for the respondent in *Helvering* v. *Marshall*, Number 484, present Term.

ARGUMENT.

I.

The Taxing Statute as Amended Is Not Applicable to the Transfer Involved.

The Circuit Court of Appeals held that Section 302(c), Revenue Act of 1926, as amended by Joint Resolution (Pub. 131), approved March 3, 1931, is applicable to the facts of this case because decedent received the income from the trust created on February 17, 1932, until her death. No question with respect to that trust having been created in contemplation of death is involved. This decision of the court was based upon the court's conclusion of law that decedent was the absolute owner of that property constituting the corpus of the 1932 trust at the time of its creation (R. 167). The facts of the case never have been in dispute.

It is the contention of respondent that this conclusion of law arrived at by the Circuit Court of Appeals is erroneous, because it is contrary to the undisputed facts.

An analysis of these facts, as contained in the agreed statement of evidence (R. 17-36), and as stated by the Board of Tax Appeals (R. 135-145), and by the Circuit Court of Appeals (R. 165-167), in their respective opinions, will demonstrate this error.

It is a well recognized rule that a compromise agreement such as that here involved which is entered into for the purpose of terminating pending litigation by the mutual

adjustment of the claims of the contending parties[1] is supported by a valid consideration[2] and is entitled to specific performance in equity.[3]

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[1]The function of a compromise agreement is not to admit the validity of any claim urged by any of the parties thereto, but is to enable said parties to settle the pending litigation by resolving the conflicting claims in such manner as they shall see fit, in order to terminate the dispute. *McDole* v. *Kingsley*, 163 Ill. 433; *Pool* v. *Docker*, 92 Ill. 501; *Sigsworth* v. *Coulter*, 18 Ill. 204; *Cheshire* v. *Des Moines City Ry. Co.*, 153 Iowa 88.

In such an agreement, with respect to litigation honestly inaugurated and earnestly prosecuted, the parties determine among themselves the value which they place upon their respective interests for the purpose of settling the controversy, and it is immaterial on whose side the right ultimately would prove to be, if the litigation should be prosecuted to a conclusion, for it must always be on one side of the controversy or the other. *Honeyman* v. *Jarvis*, 79 Ill. 318; *McKinley* v. *Watkins*, 13 Ill. 140, 144.

[2]There is a valid consideration for such a compromise agreement, which consideration is expressed in the mutual adjustment by the respective parties of the value of their respective interests under the agreement. *McDole* v. *Kingsley*, 163 Ill. 433; *Pool* v. *Docker*, 92 Ill. 501. The determination of such values will usually result in the exchange of the respective claims to interests under the existing controversy for new interests, different either in quantity or quality from the interests claimed. Cases are numerous in which such exchanges have been upheld, the determination of the values of the respective interests of the disputants constituting a perfect *quid pro quo*. See, for example, *Murphy* v. *Booker*, 139 Ark. 469; *Jones* v. *Abbott*, 228 Ill. 34; *Owings* v. *Owings*, 3 Ind. 142; *Rowe* v. *Rowe*, 187 Iowa 640; *Tudor* v. *Vail*, 195 Mass. 18; *O'Brien* v. *Weiler*, 68 Hun 64 (aff'd 140 N. Y. 281); *Dearing* v. *Selvey*, 50 W. Va. 4.

[3]The rule is well settled in Illinois that the provisions

Therefore the contract of settlement itself fixed and determined the interests of the donor and the beneficiaries in the 1927 trust fund. It must then follow that the conclusion of law arrived at by the Circuit Court of Appeals that the effect of the entry of the decree was to revest in decedent absolute ownership of *all* the property held under the 1927 trust "free of right, title, or claim of any other person", (R. 167) is a *non sequitur*. The beneficial ownership of the life interest of Virginia Smith, widow of Edward, and of the remainder interests of decedent's two daughters under the 1932 trust, must have vested in them under the contract of settlement. Decedent retained the life interest in that one-third of the 1927 trust fund which she already had. As to that one-third, the decree merely reinvested decedent with legal title, subject to the beneficial ownership fixed by the compromise agreement, for the purpose of giving effect to the provisions of the agreement.[4]

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of such a compromise agreement, where all questions of origin and extent of the respective legal rights of the parties are resolved by the compromise, will be specifically enforced in equity. *Stedman* v. *Tate*, 326 Ill. 442; *Hagen* v. *Anderson*, 317 Ill. 173; *Jones* v. *Abbott*, 228 Ill. 34; *McDole* v. *Kingsley*, 163 Ill. 433; *Hall* v. *Hall*, 125 Ill. 95.

[4]The provisions of such a compromise agreement may be effectuated, in whole or in part, by the entry of a decree in the pending litigation by consent of the parties. A decree entered by consent of the parties, pursuant to such a compromise agreement, is not a judicial determination of the legal rights of the parties in the pending litigation, but merely records the agreement of the parties and gives it judicial recognition and approval. *Murphy* v. *Booker*, 139 Ark. 469; *Hastings* v. *Nesmith*, 188 Mass. 190.

The rights of the parties under such a decree are based upon contract. *Bergman* v. *Rhodes*, 334 Ill. 137, 143; *Paine* v. *Doughty*, 251 Ill. 396, 400; *Ellis* v. *Hunt*, 228 Mass. 39.

The decree, of course, also served to determine that the provisions of the compromise agreement with respect to the treatment of the 1927 trust fund were for the best interests of the infant beneficiaries and that the agreement was binding upon them.[5]

It is true, as stated by the court, that a court decree, when entered, has the same force and effect as a decree *in invitum* (R. 167). Thus, the entry of the decree had the same effect as the giving of a deed to decedent by the

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[5]If the interests of infants are in controversy and the dispute is compromised by the adult parties in interest, in order for the compromise to be binding upon the infants, it must be determined by the court that the provisions of the compromise agreement are for the benefit of such infants, since a court of equity may authorize a compromise of an infant's litigation where the evidence shows that the case is a proper one for such compromise. *Wolf* v. *Uhlemann*, 325 Ill. 165, 185; *Matthews* v. *Doner*, 292 Ill. 592, 595; *Williams* v. *Williams*, 204 Ill. 44, 57. This determination is made where a *guardian ad litem* submits the agreement to the court, and the court approves it after an examination of the facts. *Thompson* v. *Maxwell Land Grant & Railway Company*, 168 U. S. 451, 462; *Dickson* v. *Neal*, 2 F. (2d) 533, 537 (C. C. A. 8th); *Metzner* v. *Newman*, 224 Mich. 324; *Brooke* v. *Lord Mostyn*, 33 Beav. 457, 458, 55 Eng. Rep. 445. The action of the court in such instance is not a judicial determination of what the rights of the infants would have been if the pending litigation had been prosecuted to a conclusion, but is merely a determination that the proposed settlement of the controversy is for their benefit. Upon such a determination, the agreement resolving the questions in litigation will be binding upon the infant parties in interest, (*Thompson* v. *Maxwell Land Grant & Railway Company, supra; Dickson* v. *Neal, supra; Metzner* v. *Newman, supra; Brooke* v. *Lord Mostyn, supra*) and may be enforced by them as an agreement made for their benefit. *Guy* v. *Hansow*, 86 Kan. 933, 937; *Hammassapoulo* v. *Hammassapoulo*, 134 S. C. 54, 61.

trustee would have had, but this could not affect the beneficial ownership of the property concerned, *for it must be remembered that at the time of the entry of the decree, entire beneficial ownership of that part of the 1927 trust property which was to comprise the 1932 trust was already determined under the provisions of the compromise agreement.* Entry of the decree was merely one of the means of effectuating the agreement. See *Guy* v. *Hansow*, 86 Kan. 933.

Since there was a valid subsisting compromise contract which, as the undisputed facts show, included the provision for creation of the new trust of one-third of the corpus of the 1927 trust, then the holding of the Circuit Court of Appeals that the effect of the decree was to restore to decedent absolute ownership of *all* the property transferred under the 1927 trust *is a holding that the decree entered by consent of the parties in pursuance of the agreement had the effect of nullifying the agreement.* The two propositions (1) that there was a valid subsisting compromise agreement which contemplated the creation of the new trust, and (2) that the decree operated to restore to decedent absolute title to all the 1927 trust property free of the trust and of the claims of any party, cannot stand together.

It is respondent's contention that, aside from the question of application of the exemption clause of the statute, the statute itself can have no application to the 1932 trust, for the reason that it was not created by decedent as a gratuitous transfer of property owned by her. But even if it should be found that the statute has application to this trust, it must still be held not to be taxable thereunder, for the reason that the transfer of the property into the trust, whether created by decedent or not, was certainly for an "adequate and full consideration in money

or money's worth" within the language of the exemption clause of the statute. It would be difficult to imagine a case where a transfer could be represented by consideration more complete or more tangible, or more easily reducible to money value, except it be paid for in dollars and cents themselves, and such is not required by the language. See *United States* v. *Mitchell*, 74 F. (2d) 571 (C. C. A. 7th). In return for creation of the 1932 trust of one-third of the corpus of the 1927 trust, the enforcible promise to make the new will, and the outright gifts of securities to the grandchildren, decedent received back two-thirds of the corpus of the 1927 trust, free of the trust. This determination of the respective rights of the donor and the beneficiaries in the 1927 trust property under the compromise was made without regard for what their rights might have been determined to be if the pending litigation had been prosecuted to a conclusion. Whether the 1927 trust was valid in every respect, or partially or wholly invalid as in violation of the rule against perpetuities, was the point at issue, and the subject of the compromise.

The Government's argument that the tax might be defeated in any case such as this, if respondent's contentions prevail, if the settlor and beneficiaries could by mutual consent substitute one trust for another (see petitioner's brief, p. 32), is without merit. It is obvious that in any such case, as in this one, the question of taxability must be determined by the statute in force at the time of the original vesting of the interests, as upon the creation of the 1927 trust in the instant case.

The contention of petitioner that the consideration was not such as to swell decedent's estate is contrary to the facts. Decedent's estate *was* increased to the extent of approximately $200,000 as the result of effectuation of the settlement (two-thirds of the 1927 trust corpus, valued

at approximately $220,000, less the $20,000 gifts in securities to the two grandchildren). This property was included in decedent's taxable estate at the time of her death. But, even if such had not been the case, petitioner's argument has been repeatedly rejected by the courts. *Taft* v. *Commissioner*, 92 F. (2d) 667 (C. C. A. 6th); *Commissioner* v. *Porter*, 92 F. (2d) 426 (C. C. A. 2d); *Carney* v. *Benz*, 90 F. (2d) 747 (C. C. A. 1st); *Commissioner* v. *Bryn Mawr Trust Co.*, 87 F. (2d) 607 (C. C. A. 3d); *United States* v. *Mitchell, supra.*

But with respect to the question of consideration, respondent does not rest his case upon the exemption clause of the statute, since the question of consideration here is a much deeper one than mere compliance with the exemption clause, being whether the statute itself can have any application where the consideration for creation of the 1932 trust was the mutual determination by the beneficiaries of the 1927 trust of the value of their respective interests under that trust, by virtue of the contract of settlement.

Decedent, in executing the 1932 trust instrument, dealt with the bare legal title revested in her by the decree as "trustor" for the benefit of the beneficial owners of the property. This does not mean that decedent was the real transferor or creator of the trust. The beneficial owner of the property transferred and not the nominal "trustor" is the real settlor of a trust. *De Rousse* v. *Williams*, 181 Iowa 379; *Culross* v. *Gibbons*, 130 N. Y. 447; *Maynard* v. *The Farmers Loan & Trust Co.*, 208 App. Div. 112 (aff'd 238 N. Y. 592.

Section 302(c) provides that property shall be included in the decedent's gross estate, for Federal estate tax purposes, "To the extent of any interest therein of which the

decedent has at any time made a transfer, by trust or otherwise . . ." (Italics supplied.) By no possible construction may the statute include within its scope, property transferred by persons other than decedent, as was the case here, where, under the compromise agreement, the beneficiaries of the 1927 trust dealt with the property interests vested in them under that trust, in such manner as to settle their controversy as to the validity of that trust and to determine the value of their respective interests thereunder, a part of such compromise consisting of the creation of a new trust for their own benefit.

The corpus of the irrevocable 1927 trust was not subject to Federal estate tax. *May* v. *Heiner*, 281 U. S. 238; *Burnet* v. *Northern Trust Co.*, 283 U. S. 782; *Morsman* v. *Burnet*, 283 U. S. 783; *McCormick* v. *Burnet*, 283 U. S. 784.

Therefore, the corpus of the 1932 trust, the beneficial ownership of which was never in decedent after her creation of the 1927 trust, cannot be subject to the tax.

II.

The Constitutional Question—Pure gifts inter vivos may not constitutionally be classified with transfers at death and transfers testamentary in character for the purpose of subjecting them to Federal estate tax.

There is no doubt but that Congress may tax pure gifts *inter vivos* as such. No question with respect to the existence of such power to tax is involved in this case. The question is whether Congress has the power to reach such gifts, not by a tax upon gifts *inter vivos*, but by classifying such transfers with transfers at death and transfers testamentary in character for the purpose of subjecting them to Federal estate tax. It is the contention of respondent

that such classification is so arbitrary and capricious as to be a denial of due process of law under the Fifth Amendment, and it was so held by the Circuit Court of Appeals in this case. Thus the question is one of the constitutional exercise of the admitted power.

It has been determined by this Court that a transfer such as that here involved—an irrevocable *inter vivos* transfer with remainders vested at the time of the transfer but with the reservation of income to the transferor for life—is a pure gift *inter vivos* and not testamentary in character. *May* v. *Heiner,* 281 U. S. 238. Pure gifts *inter vivos* have been determined by this Court not to be within the scope of the Federal estate tax, but properly taxable as gifts, and the classification of pure gifts *inter vivos* with transfers at death and transfers testamentary in character has been held to be a denial of due process of law under the Fifth Amendment. *Heiner* v. *Donnan,* 285 U. S. 312. Since such *inter vivos* transfers which bear no relation to death may be taxed as gifts, their classification with transfers at death and transfers testamentary in character, in an attempt to force them within the scope of the Federal estate tax, is not necessary to prevent evasion of tax. But even if the tax were a measure necessary to prevent evasion, it could not be upheld if unconstitutional for any reason.

The contentions of the Government in support of the tax rest upon two principal propositions: (1) that an *inter vivos* transfer which reserves to the transferee a life estate, operates as a reasonable substitute for a testamentary disposition, and as such properly may be classified with transfers at death and *inter vivos* transfers testamentary in character; (2) Congress was justified in making the classification because it reasonably anticipated that such transfers "might" be made to avoid estate taxes, and it had ample power to prevent such evasion.

Each of these contentions ignores the following fundamental principles of law applicable to Federal estate taxes, which have been consistently applied by this Court:

A. The Type of Transfer here Involved is a Pure Gift Inter Vivos.

An *inter vivos* transfer is a pure gift *inter vivos* where, at the time of the transfer, the transferor divests himself of all interest in the property transferred, and where the death of the transferor does not bring into being, or ripen for the transferee or anyone else, any property right or interest. *Heiner* v. *Donnan*, 285 U. S. 312, 323.

The type of transfer here involved—an irrevocable *inter vivos* transfer with remainders vested at the time of the transfer, the transferor reserving the income for life—was held by this Court to be a transfer complete when made and not to be testamentary in character in *May* v. *Heiner*, 281 U. S. 238, and in the three *per curiam* cases following that case, *Burnet* v. *Northern Trust Co.*, 283 U. S. 782; *Morsman* v. *Burnet*, 283 U. S. 783, and *McCormick* v. *Burnet*, 283 U. S. 784.

In *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 347, the Court had said:

> "In its plan and scope the tax is one imposed on transfers at death or made in contemplation of death and is measured by the value at death of the interest which is transferred. Cf. *Y. M. C. A.* v. *Davis*, 264 U. S. 47, 50; *Edwards* v. *Slocum*, 264 U. S. 61, 62; *N. Y. Trust Co.* v. *Eisner*, 256 U. S. 345, 349. It is not a gift tax, * * * One may freely give his property to another by absolute gift without subjecting himself or his estate to a tax, but we are asked to say that this

statute means that he may not make a gift *inter vivos*, equally absolute and complete, without subjecting it to a tax if the gift takes the form of a life estate in one with remainder over to another at or after the donor's death. It would require plain and compelling language to justify so incongruous a result and we think it is wanting in the present statute.

". . . In the light of the general purpose of the statute and the language of § 401 explicitly imposing a tax on net estates of decedents, we think it at least doubtful whether the trusts or interests in a trust intended to be reached by the phrase in § 402(c) 'to take effect in possession or enjoyment at or after his death,' include any others than those passing from the possession, enjoyment or control of the donor at his death and so taxable as transfers at death under § 401. That doubt must be resolved in favor of the taxpayer."

In *May* v. *Heiner* this language of the *Reinecke* case was quoted and followed. Here the Court held that an irrevocable *inter vivos* transfer with remainders vested at the time of the transfer, but with the reservation of a life estate either mediately or immediately to the transferor, —the type of transfer involved in the instant case,—is a transfer complete when made, and is not a transfer testamentary in character because of the reservation of a life estate. The transfer was held not one "intended to take effect in possession or enjoyment at or after death" within the meaning of Section 402(c), Revenue Act of 1918. The Court said, (at p. 243):

"The transfer of October 1st, 1917, was not made in contemplation of death within the legal significance of those words. *It was not testamentary in character* and was beyond recall by the decedent. *At the death of Mrs. May no interest in the property held*

under the trust deed passed from her to the living; title thereto had been definitely fixed by the trust deed. The interest therein which she possessed immediately prior to her death was *obliterated* by that event." (Italics supplied.)

In *May* v. *Heiner,* the reservation of the life estate to the transferor was made subject to a life estate provided for the transferor's husband. The decision in *May* v. *Heiner* was followed in the three *per curiam* decisions of *Burnet* v. *Northern Trust Co., Morsman* v. *Burnet,* and *McCormick* v. *Burnet,* each of which involved the direct reservation of life estates to the transferors.

The test applied by this Court in the *Reinecke* case, in *May* v. *Heiner,* and in the three *per curiam* cases, to determine whether the irrevocable *inter vivos* transfers there involved were pure gifts *inter vivos* or were transfers testamentary in character, was whether said transfers were complete when made. They were held to be complete when made when the interests in the corpus of the property transferred are vested in the transferees at the time of the transfer and do not remain contingent until the decedent's death. If such interests are so vested, the obliteration of whatever interest decedent may have retained in the property, ceasing on decedent's death, does not bring the corpus of the property within the application of the taxing statute. This rule was clearly stated and applied by the Circuit Court of Appeals in this case (R. 168, 169).

This principle has been consistently applied by this Court in other cases. The test to determine whether an *inter vivos* transfer was one within the scope of the taxing statute, viz.: whether the interests transferred were vested in the transferee at the time of the transfer, was applied in *Klein* v. *United States,* 283 U. S. 231, this time working in

the Government's favor. Here there was an *inter vivos* transfer by husband to wife of a life interest in land, together with a remainder contingent upon the transferee surviving the transferor. The court held the transfer taxable under Section 402(c), Revenue Act of 1918, the decision turning upon the point that the remainder interest remained vested in the grantor, and the interest of the grantee was a contingent remainder, to become vested in her only upon the grantor's death.

Likewise, in *Helvering* v. *St. Louis Union Trust Co.*, 296 U. S. 39, and in *Becker* v. *St. Louis Union Trust Co.*, 296 U. S. 48, the same test was applied. These cases held that the reservation of a contingent possibility of reverter in the settlor of a trust, should the beneficiaries predecease him, did not make the transfer in trust one "intended to take effect in possession or enjoyment at or after his death," since death put an end to the grantor's interest, a possibility of reverter, by extinguishing it,—the *Helvering* case under Section 302(c), Revenue Act of 1924, and the *Becker* case under Section 302(c), Revenue Act of 1926, the provisions of which said two statutes in this respect are the same. In the *Helvering* case the *Klein* case was distinguished on the ground that there the interest transferred remained contingent until the grantor's death.

In cases involving retroactive application of a Federal estate tax statute the same test has been applied to deny application of the statute to *inter vivos* transfers with remainders vested before the date of its enactment. *Nichols* v. *Coolidge*, 274 U. S. 531; *Helvering* v. *Helmholz*, 296 U. S. 93; *White* v. *Poor*, 296 U. S. 98. Although these cases dealt with the retroactive application of the statute, if no vested property rights had been involved, the retroactive application of the taxing statute would not have been fatal.

Thus the rule has been definitely established that an irrevocable *inter vivos* transfer not made in contemplation of death, with remainders vested at the time of the transfer in persons other than the transferor, but with a reservation to the transferor of the income during his lifetime, is a transfer complete when made, and is not testamentary in character, merely because of the reservation of a life estate.

The fact that the transferor has reserved to himself a part of the total value of the corpus owned by him prior to the transfer, which part is represented by the right to income from the corpus during his life, does not mean that he has not completely divested himself of all right and interest in that part which he has transferred, viz.: the vested remainders.

The Government, in contending that the reservation of income by the transferor renders the transfer in effect a testamentary disposition, merely repeats the same argument which it made in *May* v. *Heiner* and in the three *per curiam* cases. The decision in these cases, that such a transfer *complete when made* is *not testamentary in character,* is the conclusive answer to the Government's argument.

But the Commissioner contends that such a transfer is not a pure gift *inter vivos,* but is a reasonable substitute for a testamentary transfer, on the theory that the reservation of a life estate gives to the transfer in and of itself an inherent testamentary quality. In support of his contention the petitioner relies upon two classes of cases where *inter vivos* transfers have been held by this court to be subject to the tax: (1) The cases involving gifts made in contemplation of death. *Milliken* v. *United States,* 283 U. S. 15; *United States* v. *Wells,* 283 U. S. 102;

(2) The cases involving transfers with reservation of control over the property to the transferor until death. *Reinecke* v. *Northern Trust Co., supra; Porter* v. *Commissioner,* 288 U. S. 436; *Saltonstall* v. *Saltonstall,* 276 U. S. 260.

There is no doubt but that it is proper to tax as a class all gifts where *inherent in the class* is the element which makes all transfers of the class subject to the tax, such as transfers made in contemplation of death.

The contemplation of death provision of the statute does not attempt to tax *all* gifts *inter vivos,* but is confined to such gifts as are made in contemplation of death, because the motive which induces such transfers is of the sort which leads to testamentary disposition, (*United States* v. *Wells,* 283 U. S. 102, 117), and death is the generating source of each transfer.

The transfers involved in the *Reinecke, Porter,* and *Saltonstall* cases were all transfers in which the property transferred remained subject to a power of control in the transferor until his death; in the *Reinecke* case by virtue of a power of revocation over the trusts; in the *Porter* case by virtue of a power to shift the interests of the beneficiaries; and in the *Saltonstall* case (involving the Massachusetts inheritance tax) by virtue of a power to revoke to be exercised in conjunction with one of the trustees. In each of these cases the reserved power of control to the transferor rendered the transfer incomplete until such power of control was removed by the transferor's death. In each case the gift could have been defeated at any time before death by the transferor's exercise of this power.

The relationship to death which is an inherent testamentary quality of every gift made in contemplation of death, and of every gift subject to the exercise of a power of control reserved to the transferor, because death is the

motive of the gift in the first classification and because death is the generating source of the gift in the second classification, is wholly lacking in irrevocable gifts *inter vivos* with vested remainders and with reservation of a life estate to the donor.

B. The Classification of Pure Gifts Inter Vivos with Transfers at Death and Transfers Testamentary in Character is a Denial of Due Process of Law.

1. Pure Gifts Inter Vivos not Testamentary in Character are not within the Purview of the Federal Estate Tax.

It is urged by the Government that Congress was justified in making the classification because it reasonably anticipated that such transfers "might" be made to avoid estate taxes, and that it had ample power to prevent evasion. This contention ignores the fundamental principle often announced by this Court that pure gifts *inter vivos* not testamentary in character are not within the purview of the Federal estate tax.

The scope of the Federal estate tax is limited to transfers at death and to transfers *inter vivos* which are testamentary in character. The rule was thus stated in *Helvering* v. *St. Louis Union Trust Co.*, 296 U. S. 39, 41, with particular reference to Section 302(c):

> "The substantive provision of the act which imposes the tax is §301(a); and by that provision the tax is laid 'upon the transfer of the net estate of every decedent dying after the enactment of this act.' The event which gives rise to the tax is the *death* of the decedent, with the resulting *transfer* of his estate either by will or the law relating to intestacy. When,

> therefore, §302(c) includes within the purview of §301(a) a transfer *inter vivos* 'intended to take effect in possession or enjoyment at or after his death' it does so upon the theory that such a transfer in effect is testamentary—that is to say, a substitute for either a disposition by will or a passing in virtue of intestacy."

That the type of transfer here involved is not testamentary in character merely by reason of the reservation of income by the transferor for life was determined by this Court in *May* v. *Heiner*, and the three *per curiam* cases following that decision (see *supra* pp. 21, 22).

That *inter vivos* transfers not testamentary in character and complete when made, may not constitutionally be classified with transfers at death and transfers testamentary in character in order to subject them to the Federal estate tax, was definitely established in *Heiner* v. *Donnan*, 285 U. S. 312. In that case, which held specifically that the conclusive presumption provided by Section 302(c), Revenue Act of 1926, that all transfers made within two years before death and without consideration were made in contemplation of death, was in violation of the due process clause of the Fifth Amendment, the Court said (285 U. S. 312, 322):

> "Section 301 of the Revenue Act of 1926 imposes a tax 'upon the transfer of the net estate of every decedent,' etc. There can be no doubt as to the meaning of this language. The thing taxed is the transmission of property from the dead to the living. *It does not include pure gifts inter vivos.* The tax rests, in essence, 'upon the principle that death is the generating source from which the particular taxing power takes its being and that it is the power to trans-

mit, or the transmission from the dead to the living, on which such taxes are more immediately rested • • • it is the power to transmit or the transmission or receipt of property by death which is the subject levied upon by all death duties.' *Knowlton* v. *Moore*, 178 U. S. 41, 56, 57. The value of property transferred without consideration and in contemplation of death is included in the value of the gross estate of the decedent for the purposes of a death tax, because the transfer is considered to be testamentary in effect. *Milliken* v. *United States*, 283 U. S. 15, 23. *But such a transfer, not so made, embodies a transaction begun and completed wholly by and between the living, taxable as a gift* (*Bromley* v. *McCaughn*, 280 U. S. 124), *but obviously not subject to any form of death duty, since it bears no relation whatever to death.* The 'generating source' of such a gift is to be found in the facts of life and not in the circumstance of death. And the death afterward of the donor in no way changes the situation; that is to say, the death does not result in a shifting, or in the completion of a shifting, to the donee of any economic benefit of property, which is the subject of a death tax, *Chase Nat. Bank* v. *United States*, 278 U. S. 327, 338; *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 346; *Saltonstall* v. *Saltonstall*, 276 U. S. 260, 271; *nor does the death in such a case bring into being, or ripen for the donee or anyone else, so far as the gift is concerned, any property right or interest which can be the subject of any form of death tax.* Compare *Tyler* v. *United States*, 281 U. S. 497, 503. Complete ownership of the gift, together with all its incidents, has passed during the life of both donor and donee, and no interest of any kind remains to pass to one or cease

in the other in consequence of the death which happens afterward." (Italics supplied.)

See also *Handy* v. *Delaware Trust Co.*, 285 U. S. 352.

It was held in *Heiner* v. *Donnan* that the classification is wholly arbitrary and void as a denial of due process of law, where the effect of the classification is, by creation of a fictitious status, to label as testamentary in character transfers completed between the living which are not in fact testamentary in character. This rule is applicable to the instant case, since the type of transfer involved has been determined in *May* v. *Heiner* not to be testamentary in nature.

The Government advances the argument that since the state courts had construed state succession tax statutes to include such transfers as that here involved within the category of gifts "intended to take effect in possession or enjoyment at or after death" Congress understood this type of transfer as being a substitute for a testamentary transfer. It is submitted, however, that irrespective of what motive Congress may have had for its attempted classification of such *inter vivos* transfers, *it was nevertheless limited to the proper scope of the Federal estate tax.* This is clearly demonstrated by the decision in *May* v. *Heiner* which, on the question of construction of the term "intended to take effect in possession or enjoyment at or after death" within the scope of the Federal estate tax reached a conclusion directly opposite to that reached by the state courts construing similar language in the succession tax statutes. See *Blodgett* v. *Guaranty Trust Co.*, 114 Conn. 207.

The decision in *May* v. *Heiner*, that such a gift as that here involved is not testamentary in character, but is a

completed *inter vivos* transfer when made, and the decision in *Heiner* v. *Donnan* that such pure gifts *inter vivos* may not be brought within the operation of the Federal estate tax, absolutely precludes any argument by analogy based upon the construction placed by the state courts upon succession tax statutes.

The essential distinctions between the Federal estate tax and State succession taxes have been consistently maintained by this Court. See *Coolidge* v. *Long*, 282 U. S. 582; *Saltonstall* v. *Saltonstall*, 276 U. S. 260; *Nichols* v. *Coolidge*, 274 U. S. 531; *Knowlton* v. *Moore*, 178 U. S. 41. One of these essential distinctions between the two types of taxes is that, while on the one hand the succession tax is levied upon the receipt of possession and enjoyment of the property by the transferee upon the death of the transferor, on the other hand the Federal estate tax is levied upon the *transfer* of the estate of a decedent effected by his death. Thus, under the Federal estate tax, an irrevocable *inter vivos* transfer with remainders vested is held to be complete when made, even though the transferor reserves the income for life, the life estate being merely obliterated by his death and complete ownership having been fixed at the time of the transfer. *May* v. *Heiner*, *supra*. On the other hand, under a State succession tax statute, the transfer is not complete in the transferee if there may be any shifting of economic benefits of property to the transferee upon the transferor's death. *Saltonstall* v. *Saltonstall*, *supra*. This essential distinction between the nature of the events giving rise to the two types of taxes was well stated in *Saltonstall* v. *Saltonstall*, which case involved the Massachusetts Inheritance tax, where the Court said (276 U. S. 260, 271):

> "So long as the privilege of succession has not been fully exercised it may be reached by the tax.

See *Cahen* v. *Brewster*, 203 U. S. 543; *Orr* v. *Gilman*, 183 U. S. 278; *Chanler* v. *Kelsey*, *supra*; *Moffitt* v. *Kelly*, *supra*; *Nickel* v. *Cole*, *supra*. And in determining whether it has been so exercised technical distinctions between vested remainders and other interests are of little avail, for the shifting of the economic benefits and burdens of property, *which is the subject of a succession tax*, may even in the case of a vested remainder be restricted or suspended by other legal devices." (Italics supplied.)

The petitioner relies strongly upon the decision of this Court in *Guaranty Trust Co.* v. *Blodgett*, 287 U. S. 509. An analysis of this decision will demonstrate that it is in no way determinative of the issues in the instant case. In *Guaranty Trust Co.* v. *Blodgett* the Connecticut supreme court had construed a succession tax statute of that state levying an inheritance tax upon property acquired by beneficiaries by virtue of *inter vivos* transfers "intended to take effect in possession or enjoyment at the death of the grantor or donor" to include within its language an *inter vivos* transfer with the reservation of a life estate by the donor. *Blodgett* v. *Guaranty Trust Co.*, 114 Conn. 207. The State court, however, was careful to differentiate the problem there involved, *i. e.*, the construction of a succession tax statute, from the question with respect to the Federal estate tax, because of the basic difference between the two systems of taxation. The Court, after discussing the decisions in the *Reinecke* case, in *May* v. *Heiner*, and the three *per curiam* decisions of *Burnet* v. *Northern Trust Co.*, *Morsman* v. *Burnet*, and *McCormick* v. *Burnet*, determined that the rules therein enunciated with respect to the Federal estate tax were different from the rules properly applicable to an inheritance tax statute,

and were not binding upon the court in its construction of the local statute in that case. Thus the State court said (114 Conn. 207, 217):

> " . . . It is obvious from the quotation from the opinion in the *Reinecke* case which we have given above, that the decision, upon which the succeeding cases relied, was motivated by the nature of the Federal estate tax, which is upon the transfer of, rather than the succession to, property of the decedent. *Knowlton* v. *Moore,* 178 U. S. 41, 20 Sup. Ct. 747; *Y. M. C. A. of Columbus* v. *Davis* (1924) 264 U. S. 47, 44 Sup. Ct. 291; *Edwards* v. *Slocum* (1924) 264 U. S. 61, 62, 44 Sup. Ct. 293. 'The tax is on the act of the testator not on the receipt of property by the legatees.' *Ithaca Trust Co.* v. *United States* (1929) 279 U. S. 151, 155, 49 Sup. Ct. 291; *Corbin* v. *Townshend,* 92 Conn. 501, 505, 103 Atl. 607; *Gleason & Otis, Inheritance Taxation* (4th Ed.) p. 2, *et seq.* On the other hand, with a few exceptions, the State inheritance tax statutes levy a duty or excise upon the beneficiary for the privilege or right of succession to property. *Silberman* v. *Blodgett,* 105 Conn. 192, 205, 134 Atl. 778; *Gleason & Otis, Inheritance Taxation* (4th Ed.) p. 4. The Connecticut tax is of this nature. *Blodgett* v. *New Britain Trust Co.,* 108 Conn. 715, 720, 145 Atl. 56; *Bankers Trust Co.* v. *Blodgett,* 96 Conn. 361, 365, 114 Atl. 104. The Federal cases above mentioned which are relied upon in support of the claim that the transfers here in question are not taxable, since they 'deal with the construction of Federal statutes imposing estate taxes . . . are distinguishable because of the terms of those statutes, if not on other grounds.' *Worcester County National Bank* v. *Commissioner of Corporations and Taxation* (Mass., 1931),

175 N. E. 726, 729. We have been able to discover no relevant subsequent case which has given these decisions an effect adverse to the taxability of such gifts under State succession tax statutes. * * * Therefore, we feel that we are not constrained to place a similar construction upon our own statute and are still at liberty to adhere to the views as to its meaning and scope which usually have been held as to State statutes of similar nature and terms and which we indicated in *Blodgett* v. *Union & New Haven Trust Co., supra;* these lead to the conclusion that the property which was the subject of transfer was within the meaning of the statute, and taxable accordingly."

This Court in reviewing the decision of the State court, said (287 U. S. 509, 513):

"Since the court below construed the act of 1923, * * * as embracing the event sought to be taxed, and since in that view the question of contract impairment does not arise, we are bound by the decision of that court as though the meaning as fixed by the court had been expressed in the statute itself in specific words."

Thus, it was merely held in *Guaranty Trust Co.* v. *Blodgett,* that *so far as the Connecticut succession tax was concerned,* the Supreme Court was bound by the construction placed upon the statute by the highest court of that state, and, in line with the *dictum* in *Coolidge* v. *Long,* 282 U. S. 582, 596, that "undoubtedly the State has power to lay such an excise upon property so passing after the taking effect of the taxing Act," that such construction did not offend the Fourteenth Amendment.

2. The Classification is not an Exercise of the Taxing Power within the Constitutional Limitations Determined by this Court.

The test whether, in any specific instance, the classification by Congress of an *inter vivos* transfer with transfers normally subject to the Federal estate tax amounts to a denial of due process of law, is (1) whether such classification is unnecessary or inappropriate to the proposed end,—the end being the prevention of evasion of tax, (2) whether the classification is unreasonably harsh or oppressive when viewed in the light of the expected benefit, and (3) whether the classification arbitrarily ignores recognized rights to enjoy or convey individual property. The rule was thus stated in *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85, 90:

> "Congress may adopt a measure reasonably calculated to prevent avoidance of a tax. The test of validity in respect of due process of law is whether the means adopted are appropriate to the end. A legislative declaration that a status of the taxpayer's creation shall, in the application of the tax, be deemed the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process. ***But if the means are unnecessary or inappropriate to the proposed end, are unreasonably harsh or oppressive, when viewed in the light of the expected benefit, or arbitrarily ignore recognized rights to enjoy or to convey individual property, the guarantee of due process is infringed.***
>
> "Illustrations are not lacking of cases falling on either side of the line." (Italics supplied.)

It is the contention of respondent under these principles that, since the transfer here involved has been determined by this Court to be a pure gift *inter vivos*, not testamentary in character, such a transfer completed between the living and which bears no relation to death may not constitutionally be classified with transfers at death and transfers testamentary in character for the purpose of subjecting it to the Federal estate tax, for the reason that such classification is not within the limitations upon the constitutional exercise of the taxing power defined in *Helvering* v. *City Bank Farmers Trust Co., supra.*

(a) *The Classification is not Necessary to Prevent Evasion of Tax.*

That the classification attempted by the 1931 amendment is an arbitrary and unreasonable exercise of the taxing power is further demonstrated by the fact that irrevocable *inter vivos* transfers with reservation of a life estate to the transferor are transfers which may properly be reached by a gift tax. *Bromley* v. *McCaughn*, 280 U. S. 124. Therefore, Congress, in attempting to bring such transfers within the scope of the Federal estate tax by classifying them with transfers at death and *inter vivos* transfers testamentary in character, adopted unnecessary means to the proposed end—the end being prevention of evasion of tax.

A constitutional exercise of the taxing power by Congress, by means of classification, whereby one status not normally within the scope of the tax is deemed the equivalent of another status falling normally within the scope of the taxing power, *is conditioned upon the exercise of the taxing power being one reasonably requisite to prevent evasion of tax. Helvering* v. *City Bank Farmers Trust Co., supra.* That condition is not here present, where Con-

gress might properly have levied a gift tax upon the transfer.

That Congress has mistaken the means of achieving the proposed end does not argue for the support of the tax, if the guarantee of due process is infringed.

The gift tax law enacted by the Revenue Act of 1932 was intended to, and does, apply to just such transfers as that in the instant case. The purpose of the gift tax is to reach those types of *inter vivos* transfers which may not properly be subjected to a tax upon transfers that take effect at death. See *Burnet* v. *Guggenheim*, 288 U. S. 280, 286.

Since evasion of tax here cannot mean evasion of a particular type of tax within the field of "privilege" taxes,—*i. e.*, it does not mean "evasion of Federal estate tax",—if Congress may, by a reasonable exercise of its taxing power, reach the specific transfer, as by imposition of a tax on gifts *inter vivos*, there is no evasion. Therefore the means adopted,—the classification of such a transfer as one testamentary in character in order to force it within the scope of the tax on transfers taking effect at death,—is not justifiable as a measure reasonably requisite to prevent evasion.

(b) *The classification is unreasonably harsh and oppressive when viewed in the light of the expected benefit.*

The effect of the tax upon an irrevocable *inter vivos* transfer with remainders vested at the time of the transfer, as in this case, is clearly to include in the decedent's gross estate for the purpose of measuring the death tax, property which was absolutely and irrevocably vested in persons other than decedent during her lifetime—property which was at the time of the transfer properly the subject

of a gift tax, but the transfer of which bore no relation whatever to death.

Before the death of the life tenant the value of the remainderman's interest in the property under such an *inter vivos* transfer as in the instant case is computed to be the total value of the property less the value of the life estate determined according to the mortality tables. This is present property value and not a future expectancy.

As pointed out in *Heiner* v. *Donnan*, 285 U. S. 312, 330, "the event upon which the tax is made to depend is not the transfer of the gift, but the transfer of the estate of the decedent. The tax falls upon the estate, and not upon the gift, and is computed not upon the value of the gift, but, by progressively graduated percentages, upon the value of the entire estate." The effect of the operation of the statute in such a case by inclusion of the value of the gift in the gross estate of the decedent is to tax to decedent's estate that value represented by the sole ownership of the remaindermen. This is to measure the tax on A's property by imputing to it in part the value of the property of B, a result condemned in *Heiner* v. *Donnan*, and in *Hoeper* v. *Tax Commission*, 284 U. S. 206, as in violation of the Fifth Amendment. Such a tax is particularly oppressive and amounts to confiscation of property of the estate where there has been an increase in the value of the vested remainders during the decedent's lifetime subsequent to the time of the irrevocable *inter vivos* transfer.

In *Heiner* v. *Donnan*, the Court said (285 U. S. 312, 327):

> ". . . the tax, in part, is laid in respect of property shown not to have been transferred in contemplation of death and the complete title to which had passed to the donee during the lifetime of the donor;

and secondly, *the tax is not laid upon the transfer of the gift or in respect of its value. It is laid upon the transfer, and calculated upon the value, of the estate of the decedent, such value being enhanced by the fictitious inclusion of the gift,* and the estate made liable for a tax computed upon that value. *Moreover, under the statute the value of the gift when made is to be ignored, and its value arbitrarily fixed as of the date of the donor's death.* The result is that upon those who succeed to the decedent's estate there is imposed the burden of a tax, measured in part by property which comprises no portion of the estate, to which the estate is in no way related, and from which the estate derives no benefit of any description. *Plainly, this is to measure the tax on A's property by imputing to it in part the value of the property of B,* a result which both the *Schlesinger* and *Hoeper* cases condemn as arbitrary and a denial of due process of law. Such an exaction is not taxation but spoliation." (Italics supplied).

In *Hoeper* v. *Tax Commission, supra,* where a Wisconsin statute providing for the computation of the income tax of a husband and wife on the basis of the combined total of their incomes as shown by separate returns, treating the aggregate as the income of the husband, was held to be a denial of due process of law under the Fourteenth Amendment, the Court said (284 U. S. 206, 215):

"We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the Fourteenth Amendment. That which is not in fact the taxpayer's income cannot be made such

by calling it income. Compare *Nichols* v. *Coolidge*, 274 U. S. 531, 540."

(c) *The classification arbitrarily ignores recognized rights to enjoy and convey individual property.*

With respect to the Federal estate tax it was said in *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 347:

> "One may freely give his property to another by absolute gift without subjecting himself or his estate to a tax. * * *"

The effect of the classification here involved is to bring within the scope of the death tax transfers between the living which bear no relation to death, and which, as shown hereinabove, are pure gifts *inter vivos*. The effect of this classification is to ignore individual rights to convey property between the living, and is to impose a death tax upon conveyances completed long before death and without relation thereto.

C. The Tax upon the Value of the Vested Remainders is in Effect a Direct Tax.

The effect of the classification of transfers such as that in the instant case with transfers at death and transfers testamentary in character is, so far as the vested interest of the remaindermen is concerned, to subject it to a direct tax, which is in violation of Article I, Section 9, subdivision 4 of the Constitution, because not apportioned as therein provided. When the tax levied upon the gross estate of the decedent is laid upon the value of the property of the remaindermen, irrevocably vested in them prior to the death of the transferor, the tax ceases to be an excise tax upon the privilege of transferring property, and becomes a direct tax upon the property itself.

D. If Unconstitutional as a Denial of Due Process of Law for any Reason Whatsoever, the Tax Cannot be Upheld, even though it should be a Measure Reasonably Requisite to Prevent Evasion.

It has been shown hereinabove (see *supra* pp. 35, 36) that the statute as amended is not a measure reasonably requisite to prevent evasion of tax. However, even if it were held to be a reasonable tax evasion measure, the statute, if unconstitutional on other grounds as a denial of due process of law, as hereinabove set forth, nevertheless is void. An otherwise unconstitutional tax may not be justified as a measure necessary to prevent tax evasion. *Heiner* v. *Donnan*, 285 U. S. 312; *Hoeper* v. *Tax Commission*, 284 U. S. 206; *Schlesinger* v. *Wisconsin*, 270 U. S. 230. This limitation upon the exercise of the taxing power by means of classification was stated in *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85, 92, as follows:

> "There are, * * * limits to the power of Congress to create a fictitious status under the guise of supposed necessity. Thus it has been held that an act creating a conclusive presumption that a gift made within two years prior to death was made by the donor in contemplation of death, and requiring the value of the gift to be included in computing the estate of the decedent subject to transfer tax, is so grossly unreasonable as to violate the due process clause of the Fifth Amendment. In the same category falls a statute seeking to tax the separate income of a wife as income of her husband."

In *Hoeper* v. *Tax Commission, supra*, the argument that the tax was a necessary classification in order to prevent tax evasion was rejected, the Court quoting from its opinion in *Schlesinger* v. *Wisconsin, supra*, in answer to the

argument that the claimed necessity justified the otherwise unconstitutional exaction. In the latter case the Court, in holding unconstitutional the conclusive presumption provision of a Wisconsin statute that all transfers made within six years before death were made in contemplation of death, after stating that the property transferred *inter vivos* was "subjected to graduated taxes which could not properly be laid on all gifts or, indeed, upon any gift without testamentary character," said (270 U. S. 230, 240):

> "The presumption and consequent taxation are defended upon the theory that, exercising judgment and discretion, the legislature found them necessary in order to prevent evasion of inheritance taxes. That is to say, 'A' may be required to submit to an exactment forbidden by the Constitution if this seems necessary in order to enable the State readily to collect lawful charges against 'B'. Rights guaranteed by the federal Constitution are not to be so lightly treated; they are superior to this supposed necessity. The State is forbidden to deny due process of law or the equal protection of the laws for any purpose whatsoever."

Therefore, if the taxing statute, Section 302(c), Revenue Act of 1926, as amended either by the Joint Resolution of March 3, 1931, or by Section 803(a), Revenue Act of 1932, shall be held to have any application to the transfer here involved, said statute as amended should be held to be in violation of the Fifth Amendment.

III.

The 1931 and 1932 amendments to Section 302(c), Revenue Act of 1926, may not be Construed to Apply to a Transfer before March 3, 1931, or if they may be so Construed, They are Unconstitutional.

It is contended by the Government that if respondent shall prevail in his contention that the question of liability for the tax must be determined with respect to the 1927 trust, and not with respect to the 1932 trust, then either the 1931 or 1932 amendments to Section 302(c) may be applied retroactively to tax that portion of the 1927 trust from which decedent continued to receive the income until her death by virtue of the 1932 trust.

It is the contention of respondent that neither the 1931 amendment nor the 1932 amendment may be construed to apply to such a transfer completed before March 3, 1931. However, if it should be held that either of said amendments may be construed to have such retrospective application, then said enactments so applied are in violation of the due process clause of the Fifth Amendment. The argument with respect to these questions is fully developed in the respondent's brief in *Helvering* v. *Marshall,* No. 484, present Term. To avoid duplication of argument here, reference is made to the argument in that brief as determinative of the questions here involved on this point.

CONCLUSION

The judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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January, 1938.

APPENDIX

As originally enacted, Section 302(c) of the Revenue Act of 1926, c. 27, 44 Stat. 9, provided:

> The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—
>
> * * *
>
> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * * (U. S. C., Title 26, Sec. 411.)

The 1931 amendment of Section 302(c), Joint Resolution (Pub. 131), approved March 3, 1931, c. 454, 46 Stat. 1516, amended subsection (c) to read as follows:

> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, *including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom;* except in case of a

bona fide sale for an adequate and full consideration in money or money's worth" * * * (U. S. C., Title 26, Section 411(c)). (Italics represent matter added by 1931 amendment).

The 1932 amendment of Section 302(c), Section 803(a), Revenue Act of 1932, c. 209, 47 Stat. 169, amended said subsection (c) to read as follows:

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, *or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life* or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the *right to the income from, the property,* or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * *" (U. S. C., Title 26, Section 411). (Italics represent matter changed by 1932 amendment, so far as material to this case.)